



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

**Uniformity Committee Meeting
Income and Franchise Tax Subcommittee
Charleston, South Carolina
November 29 - 30, 2011
Minutes of the Meeting**

I. Welcome and Introductions.

The Chair, Robynn Wilson of Alaska, called the meeting to order at 1:00 P.M. local time and welcomed the attendees at the conference and on the phone. The following persons attended the meeting in person or via telephone:

Name of Attendee	Affiliation	Name of Attendee	Affiliation
Richard Cram	Kansas	Wood Miller Alana Berrigán-Scott	Missouri
Jack Mansun	Minnesota	Frank O'Connell	Georgia
Joe Garrett Michael Mason Julie McGee	Alabama	Miles Vosberg Matt Pereyl Donnita Wald Cory Fong Ryan Rauschenberger	North Dakota
Ben Miller	California FTB	Stewart Binke	Michigan
Craig Griffith	West Virginia	Tim Donovan Jim Etter	South Carolina
Jennifer Hays	Kentucky Legislature	Nancy Prosser	Texas
Gary Humphrey	Oregon	Glenn White	Michigan Treasury
Michael Fatale	Massachusetts	Phil Horwitz	Colorado
Lennie Collins	North Carolina		
		Karen Boucher	Deloitte
Rebecca Abbo	New Mexico	Terry Frederick	Sprint
Eric Scheiner	Idaho		
Shirley Sicilian Roxanne Bland Bruce Fort	MTC	Brenda Gilmer Gene Walborn Derek Bell	Montana

II. Public Comment Period.

There were no public comments.

III. Reports and Updates.

A. Legislative Report. MTC Counsel Roxanne Bland passed out a two page report dated November 29, 2011 on pending and anticipated federal legislation and briefly discussed the following bills or anticipated actions:

1. H.R. 1439, Business Activity Simplification Act of 2011. Would expand P.L. 86-272 immunity from taxation to persons selling intangible property and services and would impose a “permanent physical presence” standard for income taxation. Mark-up held 7/7/11, passed House Judiciary Committee. *Current activity:* None.
2. H.R. 1864, Mobile Workforce State Income Tax Simplification Act of 2011. Limits state taxation of the wages or other remuneration of any employee who performs duties in more than one state to: (1) the state of the employee's residence; and (2) the state in which the employee is present and performing employment duties for more than 30 days. Exempts from the definition of "employee" for purposes of this Act a professional athlete or entertainer or certain public figures. Introduced on 5/12/11. *Current Activity:* 11/17/11 marked up and approved by the House Judiciary Committee.
3. S. 1811, Telecommuter Tax Fairness Act. Prevents states from applying income tax laws to a nonresident unless the nonresident is physically present in the state. A nonresident (including independent contractors) is not working in a state regardless of whether the nonresident is working outside the state for its own convenience, or whether it fails the employer convenience test. For purposes of deeming whether compensation is paid, no state may deem the time an employee is physically present in a state to be not normal working time, non-working time, or non-compensated time unless the employer deems it to be such. The Act does not apply to corporations, partnerships and the like, nor does it apply to unearned income such as royalties, dividends, etc. Introduced 11/7/11. *Current Activity:* None.

B. Report on Commission Activities:

1. Model Statute for Disallowance of Deductions for Payments to Captive REITs. MTC Counsel Bruce Fort reported that the model statute has been approved and adopted by the full Commission as of July of 2011. Mr. Fort cautioned that the definition of “captive REIT” may need to be reviewed to consider the consequences of captive REITs issuing of small amounts of preferred stock in public offerings.
2. Model Mobile Workforce Statute. MTC General Counsel Shirley Sicilian reported that the Model Statute has been adopted by the full Commission as of July 2011.

3. Model Statute for Combined Reporting: Definition of “Tax Haven.” Mr. Fort informed the subcommittee that the amendment was approved by the full Commission in July, 2011.
4. Partnership or Pass-Through Entity Income Ultimately Realized by an Entity that is Not Subject to Income Taxation. Ms. Sicilian reported, on behalf of MTC Counsel Sheldon Laskin who was unable to attend the meeting, that the Uniformity Committee had previously approved this model statute and the Executive Committee has approved it for public hearing. Upon consideration of the hearing officer’s report, the Executive Committee heard from the insurance industry that it would propose an alternative model for addressing the committee’s concerns. The executive committee asked the uniformity committee to work with the insurance industry to consider these alternatives and report back to the executive committee. Pursuant to that directive, the subcommittee will be hearing from a representative of the National Association of Insurance Commissioners later in the meeting.
5. Amendment of Multistate Tax Compact, Art. IV.1(g)(Definition of Sales). Ms. Sicilian reported that model language approved by the uniformity committee is now before the executive committee for consideration for public hearing. The executive committee will take the proposal up at its December 1, 2011 meeting in two days.
6. Amendment of Multistate Tax Compact, Art. IV.17(Sales Factor Sourcing for Intangible Property and Services.) Ms. Sicilian reported that model language approved by the uniformity committee for this proposal is also now before the executive committee for consideration for public hearing. The executive committee will take this proposal up at its December 1, 2011 meeting in two days.

IV. Project to Amend MTC Model Financial Institutions Apportionment Rule.

Working Group Chair Lennie Collins of North Carolina reported that the working group continues to meet on a frequent basis. It has turned its attention to the property factor, including clarifications of “material change” and amendments to the “SINAA” rule. Mr. Collins asked if Ms. Boucher, who has represented members of the banking community, if she had comments to add and she did not.

V. Project to Amend Multistate Tax Compact Article IV.9 (Factor Weighting).

Ms. Sicilian outlined her memorandum of November 4, 2011 addressing legal and policy issues for weighting the apportionment factors. She listed several options for the subcommittee: (a) retain the three-factor formula; (b) double-weighted sales; (c) sales-only factor; (d) state chooses from among listed options; (e) taxpayer chooses, with consistency restrictions.

Public Comments: Diann Smith of Sutherland (appearing via phone) commented on options “D” and “E” that some taxpayers would be concerned that the states would not be able to agree on range of options and conditions, leading to possible double taxation or loss of ability to elect.

Committee Comments:

Ben Miller of California FTB offered that the three-factor formula was outdated as a matter of conformity and may not reflect the economics of income generation for some segments of the economy. Miller cautioned against adopting a single factor formula as it could be subject to challenge based on constitutional grounds in an appropriate case.

Wood Miller of Missouri expressed concerns about the administrative costs of tracking a taxpayer’s ability to elect options under E, although he expressed support for option D as having worked in Missouri. Phil Horwitz of Colorado defended option E as workable and ensuring full apportionment if all states agreed on ground rules. Glenn White of Michigan expressed concern with the political consequences of adopting a double-weighted sales factor when so many states had moved to a single sales factor. Several committee members expressed the sentiment that the model statute should be based on the best model, regardless of political ramifications. Mr. Horwitz then moved for adoption of option B, the double-weighted sales factor. Before that motion was heard, a discussion was held as to whether “cumulative voting” was preferable to ensure that the ultimate choice was based on more than a plurality of first choice votes. The delegates were instructed to assign declining numerical values to the first through fifth votes. A motion to approve cumulative voting was approved by the Committee 12-1, with three abstentions. The subcommittee then cast a series of votes on each option, starting with option A.

Results: Option B (double-weighted sales) was selected with ten 1st place votes, three 2nd place votes, two 3rd place and one 4th place vote. Option A (retain equal weighted 3-factor formula) was second with four 1st place votes, nine 2nd, and three 4th place votes. Option C (single sales factor) garnered one 2nd, four 3rd, five 4ths and six 5ths. Options D (state choice) received two 1st place votes, three 2nd place votes, six 3rd place votes, and five 4th place votes. And option E (taxpayer choice) only received third, fourth and fifth place votes. The subcommittee then voted 12-0 to recommend option B, with three abstentions.

XI. Project to Study Review of Regulations on “Taxable in Another State.”

The Chair elected to hear the “taxable in another state project” (topic IX on the printed agenda) at this time to accommodate public testimony expected on the following day.

Mr. Fort outlined two previous memoranda to the subcommittee on the project. The memoranda included a request for uniformity members to contact their legal and audit staffs to determine if states were encountering problems with taxpayers manipulating their tax status in destination states or filing inconsistently with regard to their taxable status in other states.

There were no public comments at this time.

The subcommittee did not hear of examples of abuse of the “taxable in another state” provisions of the Compact. After a brief discussion, the subcommittee expressed a desire to postpone a final determination on whether to eliminate the project entirely until more information is obtained from within agencies.

The subcommittee then adjourned for the day at 5:20 p.m. local time.

Wednesday, November 30, 2011

The subcommittee reconvened at 8:30 a.m. on November 30, 2011.

VI. Project to Amend Multistate Tax Compact Art. IV.1(a) (Definition of Business Income).

Ms. Sicilian outlined her memorandum of November 18, 2011 to guide committee discussions. The memorandum includes legal and policy background on the topic. Ms. Sicilian also provided a list of policy issues and four alternative drafts that illustrate some of these policy choices for the subcommittee. All four draft options would make clear that the definition of business income contains two distinct tests, a transactional test and a functional test.

Option A would retain most of the current business income definition but would exclude the prefatory phrase “and includes income from” before the functional test.

Option B would also remove the prefatory phrase noted above, ensuring two tests, would specifically state that income should be apportioned to the extent allowed under the constitution, and would slightly expand the scope of the functional test to include activities related to the employment and development of property that “materially contributes to” the taxpayer’s trade or businesses.

Option C follows Option B in form but does not include the requirement that functions related to property must “materially contribute” to a trade or business.

Option D expands the functional test definition in a manner similar to options B and C, but goes on to qualify that the taxpayer may have multiple business lines, requiring application of both tests to income arising from each separate line of business.

There were no public comments at this time.

Committee Discussions:

The subcommittee discussed each of the four options. Wood Miller of Missouri expressed concerns that some courts would still find that liquidations (especially involving 38(h)(10) elections) should be considered non-business income. The subcommittee then took a series of votes on policy and drafting questions presented in the memorandum.

- A. Use “or” instead of “and” in the functional test: 13-0 in favor;
- B. Use additional phrase “employment of property” as part of functional test? 10-3-0 (yes).
Use of additional phrase “development” as part of functional test? 10-3-0 (yes)
- C. Is it clear what is meant by the “regular” course of business? 0-13 (no). Should “regular” be deleted? 11-2-1 (yes).
- D. Should liquidations give rise to apportionable income? 13-0 (yes).
- E. Should 338(h)(10) elections give rise to apportionable income? 12-1 (yes).
- F. Should test specify use of proceeds from transaction as a factor? 13-0 (no).
- G. Change use of “integral” in functional test to another qualifier or simply eliminate all qualifiers on the relationship of property to a business in functional test? 6-7 (no).
- H. Change “tangible and intangible property” in functional test to some other phrase? 1-13 (no)
- I. Should business income definition be as broad as constitution allows? 13-0-1 (yes)
- J. Should that constitutional reach be specified in the statute? 6-5-2 (yes).
- K. Should business income definition be re-titled? 5-5-3. (tie – will review again)
- L. Should statute explicitly address situation where taxpayer has more than one unitary business line? 1-12-0 (no)

The subcommittee directed the drafting group to incorporate these policy choices into a next draft.

VII. Project to Amend Multistate Tax Compact Article IV.18 (Distortion Relief).

Ms. Sicilian outlined her memorandum of November 18, 2011, which provides some legal and policy background for the project and states the executive committee’s the goal of clarifying states’ Compact Art.IV.18 authority for addressing distortion through industry-wide and issue-wide regulations as well as on an ad hoc basis. .

Public Comment: Diann Smith of Sutherland commented that the use of equitable apportionment authority on an ad hoc basis was unfair where multiple taxpayers are engaged in the same activity yet only a percentage of those taxpayers are governed by special apportionment rules.

Committee Comments:

The subcommittee voiced approval of the drafting group’s proposed language which would add a new section (b)(1) to the Compact specifying that the Commissioner could, in addition to ad hoc application of equitable apportionment, also adopt rules relating to “particular transactions or activities or taxpayers engaged in a “particular industry.” The subcommittee also appeared to approve a new section (b)(2) which provides that special industry rules are still subject to equitable adjustment when appropriate.

Ben Miller of the California FTB asked whether it would be appropriate to remove all reference to separate accounting as a remedy, or to limit its use to allocated income; and whether combined reporting should be added as an appropriate means of relief.

The subcommittee whether the statute should use the term “procedures” rather than “regulations” to allow special industry apportionment rules through instruction or other forms of rule-making short of formal promulgation of regulations.

The subcommittee will continue its discussion at its next meeting.

VIII. Project Regarding Partnership or Pass-Through Entity Income Ultimately Realized by an Entity that is Not Subject to Tax.

Ms. Sicilian began the discussion with reference to her November 18, 2011 memorandum. The Executive Committee considered approving the model for a bylaw 7 survey at its June 6, 2011 meeting and, after receiving significant input from the insurance industry, voted to continue its discussion to its July 28, 2011 meeting. At that meeting, representatives from the insurance industry suggested again that they had concerns with the current model, had proposals that would address the committee’s concerns in a less intrusive way, and that they would be willing to work with the uniformity committee to develop those alternatives. The Executive Committee voted to ask the Uniformity Committee to work with the insurance industry on developing those alternatives and then to provide a matrix summarizing the various tax problems that arise when income taxpayers and non-income taxpayers are part of the same affiliated group and the possible solutions – existing as well as proposed models – for addressing those problems.

As part of its effort to learn more about how the proposal would affect the insurance industry in particular, the subcommittee considered the comments of Dan Shelp, managing counsel of the National Association of Insurance Commissioners. Mr. Shelp outlined the basics of insurance industry taxation and regulation by state insurance commissions. Mr. Shelp was asked a series of questions about the possibility of retaliatory taxes and insurance company capitalization and over-capitalization. Mr. Shelp closed by offering his organization’s technical assistance in developing rules.

The subcommittee asked that the drafting group be reconvened and that it work with industry and regulators to develop the information necessary for the subcommittee to respond to the executive committee’s July 2011 request, including a matrix of alternatives.

X. New Business.

None.

XI. Adjournment.

The income and franchise tax uniformity subcommittee adjourned its meeting at 12:00 noon local time.